Financial Markets

Irving Trust

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Economic Research & Planning Division

Friday (Noon) March 20, 1981

Rates moved sharply lower on balance this week, though some increases set in toward the end. The principal stimulus to the declines was the dramatic drop in the Federal funds rate, which averaged 15.53% in the week ended March 11, 14.18% in the week ended March 18, and which thus far this statement week has been averaging a bit above 13%--as was anticipated here last week. In addition, the markets were aided by reports of declines in industrial production and housing starts--about the first palpable signs of an economic slowdown received so far. However, two underlying concerns weighed on market sentiment, especially toward the end of the week. One was the question of how far the funds rate would decline in the near future. The possibility exists that some dealers may have taken positions that would be profitable only if the rate continued to fall; such expectations are easily disappointed. The other main source of concern was the large volume of Treasury and corporate securities expected to be brought to market in the near future.

In addition, many market participants had expected that a cut in either the basic 13% discount rate or the 3% surcharge would be announced Thursday night. The absence of such a move lends credence to the notion--it is hardly much more than that at this stage--that the bottom of the Fed's acceptable range for the funds rate may be 13%. If this is the case, then the recent rally may run out of steam for want of validation by declines in the funds and discount rates. Indeed, it is conceivable that the funds rate might even be forced briefly higher--as happened about four weeks ago--in which case the adverse impact on other market rates probably would be disproportionate.

Since the end of the year, rates on both 90-day CDs and 90-day commercial paper have dropped about four to five percentage points. In contrast, the rally in Treasury bills has been limited to only about two percentage points. This disparate pattern is indicative of the market's apprehensiveness about Treasury financing needs. Similarly, despite the recent rally in the long-term sector, the Treasury's 30-year "long bond" is currently priced to yield slightly more now than at the end of the year.

Of course, a large volume of offerings is not necessarily inconsistent with a bond market rally. The May-July 1980 period--when previous records for volumes of bond issues were shattered--proves that. But an extremely congested market is also highly vulnerable to bad news. For example, beginning in the summer of 1974, short-term rates fell rapidly for several months in succession. Bond rates also moved down, despite record issuing volumes. But in the spring of 1975, monetary growth speeded up temporarily, and short-term rates rose modestly for a time. That was all it took to force bond rates sharply higher.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

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Market Yields

	3/20/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	17.50%	18.00%	19.00%
Effective since	3/17/81		
Discount Rate at Federal Reserve Bank	13.00	13.00	13.00
Federal Funds	13.25	14.25	17.25
Repurchase Agreements	13.00	14.00	12.50
U.S. Treasury Issues			
Bills			
3 months	12.98	13.88	16.10
6 months	12.71	13.60	16.66
1 year	12.81	13.48	16.15
Coupons			
2 years	12.87	13.45	15.05
4 years	13.00	13.30	13.69
7 years	12.89	12.94	12.93
10 years	12.75	12.87	12.71
Long Bond	12.34	12.44	12.25
Negotiable Certificates of Deposit-Secondary Market			
1 month	13.10	14.15	17.50
3 months	13.20	14.25	18.00
6 months	13.25	14.35	18.10
1 year	13.50	14.50	17.50
Banker's Acceptances			
1 month	13.15	14.15	17.60
3 months	13.30	14.10	18.00
6 months	12.85	14.33	18.20
Eurodollar Deposits			
1 month	13.50	15.19	18.00
2 months	13.75	15.19	18.69
3 months	14.00	15.19	18.94
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	8.00	10.00	6.00
1 month	12.25	14.00	16.25
3 months	12.25	13.75	15.00
Bank Holding Companies			
1 month	12.50	14.38	16.50
Dealer Placed:			
3 months	12.00	14.25	16.88
New AA Corporate Utility Bond	14.60	14.90	14.15
Tax Exempt			
6 month Project Notes	6.40	7.05	7.20
1 year AAA Bond	6.80	7.10	NA
5 year AAA Bond	7.40	7.80	NA
20 year AAA Bond	9.00	9.65	9.10

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

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